

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
PAKWAN RESTAURANT, LLC,) OTA NO. 18043017
)
APPELLANT.)
)
_____)

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Tuesday, September 13, 2022

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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APPEARANCES:

Panel Lead: ALJ TERESA STANLEY

Panel Members: ALJ SUZANNE BROWN
ALJ DANIEL CHO

For the Appellant: ELLIOTT SPEISER

For the Respondent: STATE OF CALIFORNIA
DEPARTMENT OF TAX AND
FEE ADMINISTRATION

RANDY SUAZO
CHAD BACCHUS
JASON PARKER

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-16 were previously received at the prehearing conference.)

(Department's Exhibits A-G were previously received at the prehearing conference.)

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Cerritos, California; Tuesday, September 13, 2022

3:05 p.m.

JUDGE STANLEY: Then let's go on the record.

And again, this is Judge Stanley speaking. This is for the Appeal of Pakwan Restaurant, LLC, Case Number 18043017. It is September 23rd, 2022, and it's about 3:05 p.m. in Cerritos, California. September 13th. Okay. Good I got a whole ten days ahead of me. Thank you.

I'm Judge Teresa Stanley, and to my right is Judge Suzanne Brown. To my left is Judge Daniel Cho. Neither party objected at the prehearing conference to the substitution of Judge Brown in place of Judge Lambert. I'm going to conduct the hearing today, but as I said earlier, the Panel will equally deliberate and issue a written opinion within 20 days after the record closes. I'm going to ask --

What did I just say? 20 days. I shouldn't read. That's why. Because then I don't think. Okay.

I'll ask the parties to introduce themselves, starting with Appellant, please.

JUDGE CHO: And just a reminder, Mr. Speiser, can you talk into the mic and make sure you turn it on.

MR. SPEISER: Elliot Speiser on behalf of Appellant Pakwan Restaurant, LLC.

1 JUDGE STANLEY: Thank you.

2 MR. SUAZO: Randy Suazo, Hearing Representative
3 CDTFA.

4 MR. PARKER: Jason Parker, Chief of Headquarters
5 Operation Bureau with CDTFA. And we also have Chad
6 Bacchus, Tax Counsel with our legal division in the
7 audience.

8 JUDGE STANLEY: Okay. Thank you.

9 I wanted to let you know for both the Appellant's
10 purposes and the general public, who is viewing this, that
11 the Office of Tax Appeals is independent of any other tax
12 agency, including the California Department of Tax and Fee
13 Administration or as we call them CDTFA. The Office of
14 Tax Appeals is not a court but is an independent appeals
15 agency staffed with its own tax experts. The only
16 evidence that we have in the Office of Tax Appeals' record
17 is what was submitted in this appeal. These proceedings
18 are being live streamed on YouTube, and our stenographer
19 Ms. Alonzo is reporting the proceedings.

20 The issues that we have to decide in this appeal
21 today are whether Appellant has established that a
22 reduction is warranted to the amount of unreported taxable
23 sales for the audit period October 1st, 2008, through
24 March 31st, 2012. The second issue is whether Appellant
25 was negligent. And the third issue that was raised at the

1 prehearing conference was whether a reduction of interest
2 is warranted in this case.

3 Mr. Speiser, does that sound correct?

4 MR. SPEISER: Yes, it does, Your Honor.

5 JUDGE STANLEY: And Mr. Suazo, does that sound
6 correct.

7 MR. SUAZO: Yes, it does.

8 JUDGE STANLEY: Okay.

9 And one of my co-Panelist pointed out the
10 reduction of interest had not been raised or briefed
11 previously, and I was going to ask the Department if they
12 would like time after the hearing to be able to brief that
13 issue.

14 MR. SUAZO: Yes, we would setup a timeline.

15 JUDGE STANLEY: Okay. Okay. We'll do that at
16 the end.

17 Okay. And then for exhibits, we have Appellant's
18 Exhibits 1 through 16. Several of them are duplicates of
19 CDTFA's exhibits, including Exhibits 1 through 5, 7
20 through 11, 13, and 15 through 16. An exhibit identified
21 as Number 6 was never submitted. So we do not have the
22 Exhibit 6 that I had put in the exhibit log that was sent
23 to the parties. We don't have that exhibit.

24 Mr. Suazo, are there any objections to any of
25 those exhibits?

1 MR. SUAZO: No objections.

2 JUDGE STANLEY: Okay.

3 And CDTFA submitted an exhibit index identifying
4 Exhibits A through F, and did more recently submit Exhibit
5 G, which is a credit card sales ratio schedule.

6 Mr. Speiser, do you have any objection to any of
7 those exhibits?

8 MR. SPEISER: No objections, Your Honor.

9 JUDGE STANLEY: Okay.

10 And one more detail with respect to Appellant's
11 Exhibit Number 12. It was identified as a Board hearing
12 summary by Appellant, but it appears to be a summary
13 analysis prepared for the Department's Bureau of Tax and
14 Fee Division. So I corrected that on my own copy of the
15 exhibit log.

16 So we had talked about Mr. Speiser having to do
17 an opening statement. We talked about giving you ten
18 minutes to do that. So why don't you go ahead and
19 proceed.

20 MR. SPEISER: Thank you, Your Honor. I don't
21 believe I will need the full ten minutes, but I do
22 appreciate the opportunity.

23

24 OPENING STATEMENT

25 MR. SPEISER: Your Honors, the taxpayer's central

1 argument has been consistent throughout this entire exam
2 and appeal process, and that argument is simple. It's
3 essentially maintaining that it's been deprived of its
4 right to due process and fundamental fairness in the
5 administration of this appeal. As the record will
6 indicate, the taxpayer has always acted in good faith and
7 provided all responsive documents.

8 The Department's failure to timely administer
9 this appeal warrants terminating sanctions. This appeal
10 is an excess of ten -- approximately reaching close to ten
11 years with almost no communication from the State in that
12 time period. As the Appellant will demonstrate during
13 this appeal, the CDTFA on October -- excuse me -- issued a
14 decision back in August 27th, 2014, recommending that
15 Appellant's appeal be denied. At that oral hearing, in
16 connection with the appeal, the BOE heard their arguments
17 and sent the case back down as it did not conform to the
18 audit manual. The instructions were clear.

19 The BOE was afforded an opportunity to review its
20 findings and issue a supplemental decision, which it did
21 in February of 2015. Thereafter, we were scheduled for
22 another Board hearing. On April 13th, 2016, the record
23 will show that a week before our hearing the Board
24 requested that this matter be continued in order to file a
25 supplemental decision. That supplemental decision took

1 four-and-a-half years to be issued. There were no changes
2 in the supplemental decision, no new authorities, no
3 analysis of facts. There was something new in that
4 supplemental decision that the Appellant had to wait an
5 excess of four years.

6 The supplemental decision did not properly
7 address the reasonableness of the findings as instructed
8 by the Board members at the prior hearing, and failed to
9 address, more importantly, how the auditor can deviate
10 from the audit manual. Not only did the CDTEFA not
11 properly address the reasonableness of the findings as
12 expressed by the Board, but has failed. Again, I want to
13 emphasize it has failed to demonstrate how we can deviate
14 from the audit manual in connection with this exam.

15 So in connection with taxpayer's argument,
16 essentially, what we're maintaining is the conclusions
17 that have been reached are completely unreasonable. The
18 examination took place. And based upon the examination,
19 the agent conducted numerous independent tests, such as a
20 bank deposit analysis, a comparison of a reconciliation of
21 federal tax returns, and numerous other testings. In
22 connection with those audit findings, it's interesting
23 that the error rate for the reconciliation to the tax
24 return came out to 3.79 percent.

25 With respect to markup analysis, the markup

1 analysis, as referenced in Exhibit Number 9, falls within
2 the guidelines. And so with respect to the markup
3 analysis, it appears that their markup analysis is
4 consistent with a reasonable markup. But the reason the
5 agent does not want to use the markup analysis is he
6 maintains that he does not have confidence in taxpayer's
7 purchases. He maintains that the taxpayer is understating
8 purchases.

9 Now, the effect that would be caused by
10 understating an expense is increasing your bottom line.
11 You increase your income when you reduce expenses. So
12 although there is no explanation within the agent's
13 write-up or within supplemental decisions, at no point in
14 time do we have any understanding why a markup calculation
15 was not used, other than to say that the agent does not
16 have confidence that the complete set of substantiation
17 the expenses have been provided.

18 However, there's an easy remedy for that. You
19 simply pick up the phone or you write a communication to
20 the vendor who is supplying all these taxpayer's supplies.
21 And, again, this is a restaurant. So we know who is
22 supplying the meat. We know who is supplying the poultry.
23 We know who is supplying the vegetables. But the agent
24 doesn't want to do the extra step. So the agent takes the
25 markup analysis and sets it aside and says, I have no

1 reliability in these receipts. And, again, his contention
2 is that the taxpayer is underreporting its expenses which
3 it, again, would increase the taxpayer's income.

4 So notwithstanding that, the examiner does do
5 these alternative tests. He reconciles the federal income
6 tax return, and that produces a negligible error rate, a
7 very small error rate. In addition, he then performs a
8 bank deposit analysis. And the bank deposit analysis
9 reflects that there is more sales being reported than
10 income being deposited. And at this time, you must
11 remember that in the early part of this examine the
12 taxpayer is a cash business only. Midway through the
13 examination the taxpayer starts accepting credit cards.

14 And just for a little relevant history, the two
15 operators are both immigrants to this country. They're
16 very hard working. They are Pakistani immigrants. Their
17 restaurant serve Pakistani food and Indian food. They are
18 both nice gentlemen. They're not that sophisticated, but
19 they understand how to track their income and how to track
20 their expenses. And as the examiner noted, at the end of
21 every shift a report is prepared that sums up all the
22 receipts, and then that's posted into an Excel
23 spreadsheet.

24 We maintain that those are contemporary -- excuse
25 me -- contemporaneous business records based on the fact

1 the examiner is noting and memorializing that this
2 procedure is done every day by the financial partner. And
3 that individual is Mohammed Shahbaz. So at the end of the
4 day, the examiner says, you're reporting more income than
5 what you're depositing in the bank and, therefore, I find
6 your deposit analysis to be unreasonable and unreliable.

7 Now, normally when it's the other way around that
8 conclusion is justified when you have more money coming in
9 than what's being deposited. Here, since it's a cash
10 business, we maintain it is reasonable for the taxpayer to
11 keep a certain percentage in each of the locations,
12 because they're a cash business, they must have money for
13 their registers. And as noted in the taxpayer's notes,
14 that reconciliation was confirmed that it's performed
15 every day.

16 So at the end of the day, what we have here is a
17 cash basis, cash extensive business that early on didn't
18 accept credit cards. And based upon that activity, a bank
19 deposit analysis is performed, but that's also
20 disrespected based on the fact you're reporting more
21 income than you're depositing. We believe that's an
22 indicia that the taxpayer is following proper accounting.

23 Let's get back to the markup analysis. Again, we
24 believe that what should have been performed here was to
25 either perform an enlarged markup analysis and speak to

1 the vendors or alternatively -- and this is the thrust of
2 our argument here today -- sales in this case -- I'm just
3 going to cut to the chase. Sales in this case are being
4 projected based upon the examiner's one-day site
5 observation. We know from the Audit Manual that a site
6 observation for one day at Section 080.3, a one-day site
7 observation can be used to either impeach a taxpayer's
8 records or demonstrate that they are not complete and
9 accurate.

10 At no point in time, does the examiner discuss
11 this with the taxpayer. The examiner maintains that the
12 taxpayer is not open to increasing the site examination.
13 Notwithstanding that, the manual makes it clear that we
14 can only use these conclusions to impeach. Now, based
15 upon the information that's been provided to the examiner,
16 there are several alternative tests that can be performed.
17 Excuse me. There are several alternative tests that can
18 be performed that are prescribed by the Audit Manual when
19 the site observation demonstrates that the examiner does
20 not have comfort levels with these records.

21 First is to increase the inspection to three
22 days. At no point was the taxpayer ever notified that if
23 you do not allow an increase site inspection, we were
24 going to use the one day. And equally important we like
25 to emphasis, again, the taxpayer throughout the write-up

1 the taxpayer continues to argue that your statistics are
2 erroneous based upon your sample size. And so they
3 continue to offer additional periods.

4 They start with a two-week period. It is
5 increased to a two-month period. Again, these are the
6 taxpayers offering the examining agent additional records
7 to demonstrate we believe your site observation is
8 inaccurate. Additionally, during the site observation it
9 was brought to the agent's attention, taxpayer contends
10 that there was graduation parties with some small families
11 from the middle schools. The agent had -- well, we had
12 been asked and you go back and find the schools. At this
13 point in time, we can't even find the party. We know that
14 it was an Indian family that came with their family. They
15 were celebrating a middle school.

16 And this was a representation made during the
17 examination. This is not made from my office. We're just
18 advancing this because it was a contemporaneous statement
19 made by the taxpayer, not the taxpayer's rep. And, again,
20 we emphasize the fact that the taxpayer has no background
21 in any type of tax procedure or tax controversy. We
22 maintain that -- similar to dying declaration, this
23 individual's statements do hold a lot of weight for truth
24 and veracity. And based upon the relationship that the
25 agent memorializes in their write-up, it was a very

1 cooperative relationship. This was not an adversarial
2 relationship.

3 And don't get me wrong. Nobody enjoys having any
4 taxing agency come in and do an examination. And,
5 therefore, with respect to the taxpayer's position that we
6 don't want to increase this site observation, again, if
7 they were just informed that if you don't there are going
8 to be consequences or we're going to be limited in what we
9 can do. But the Manual makes it clear at no point can you
10 use a one-day's observation to project sales.

11 The remainder of our exhibits are essentially the
12 fruits of this tainted tree. Our other exhibits, if we go
13 through the exhibits, basically what has occurred is the
14 one-day sample produces an average sale. That average
15 sale then is intertwined into all of the agent's
16 projections and determinations with respect to projected
17 sales. We also want to emphasize the fact that this
18 observation occurs outside of the audit period. As
19 accurately pointed out, when we were doing our
20 housekeeping, the audit period here is from October 1st,
21 2008, through March 31st, 2012. The observation occurs on
22 May 30th, 2012, essentially, two months after the audit
23 period.

24 In addition, during 2011, the taxpayers among
25 their several locations made improvements. These are

1 essentially cosmetic improvements. They're not
2 structural. But what they did do is put in new bathrooms,
3 which everyone would appreciate when you're going to a
4 restaurant. They also installed new tiles. Now, the
5 agent indicates that he has no substantiation for these
6 expenditures.

7 The taxpayer has maintained look -- because he
8 went to the federal tax returns. Take a look at the
9 federal tax returns. Look at the expenses with respect to
10 the 179 depreciation and the other expenses listed with
11 respect to improvements. They're contained within the tax
12 returns, and it's clear. So, again, these are
13 representations that were made by the taxpayer, not the
14 taxpayer's rep because the taxpayer was involved during --
15 was present, and we want to emphasize that. This is not
16 coming from their hired representative, their accountants.

17 This is coming from the taxpayer. And we put a
18 lot of weight on that only because the taxpayer, when he
19 was confronted with this, the first thing that the
20 taxpayer brought up was the fact that, hey, the day you
21 came, we -- it's graduation season. In addition, when you
22 look at the write-up in connection with the site
23 observation, it's clear from the agent that Thursdays,
24 Fridays, Saturdays are the busiest days of the week;
25 Friday and Saturday being the busiest.

1 The site observation here was conducted on a
2 Wednesday. Now, some of those restaurants are closed on
3 Monday and Tuesday. So, essentially, what we have is a
4 four-day period for some of these restaurants. So with
5 respect to three busiest days, the agent elects not to use
6 one of those days. We believe consistent with the Audit
7 Manual.

8 JUDGE STANLEY: Can I stop you for a second?

9 MR. SPEISER: Certainly.

10 JUDGE STANLEY: I'm sorry to interrupt. But we
11 had talked at the prehearing conference about giving you
12 some time for an opening statement and also for witness
13 testimony, but it doesn't appear you have any witnesses
14 with you?

15 MR. SPEISER: Right. And I had told the person
16 when I checked in that the witnesses would not be
17 appearing today.

18 JUDGE STANLEY: Okay. That's fine. I just
19 wanted to know if I should go ahead and let you keep
20 talking and use the time that we allotted for them. So
21 you can proceed. Sorry to interrupt.

22 MR. SPEISER: Not a problem. Thank you.

23 So in connection with the audit findings, again,
24 in connection, if you look at Exhibit 8, this Exhibit 8
25 basically indicates consistent with the Audit Manual that

1 there was an exception that the Department would go in
2 there, and with respect to projecting sales, it would have
3 to have a site observation of more than one day.

4 And so the taxpayer has always maintained --
5 well, he'd been given instructions to go back and review
6 your determinations. Based upon the fact that you're
7 projecting sales in violation of the Manual and that's
8 because it's based only on a one-day observation, as well
9 as the fact that no consideration is given to the -- and
10 if you look at the federal tax returns, there's
11 year-over-year growth in the tax returns year. There's
12 year-over-year with respect to the sales tax returns that
13 have been filed.

14 Credit cards are now being accepted, which really
15 makes a difference in their business. They've made these
16 improvements to these locations. And as the examiner
17 notes in connection with his write-up, the taxpayer is now
18 offering all types of marketing and specials. They have
19 these lunch specials. So when the examiner started to
20 determine an average net sales amount and some of the
21 locations are coming up with the wrong conclusion,
22 essentially, that the taxpayer appears to have been over
23 reporting.

24 And let me bring your attention to -- the
25 examiner, if you look at Exhibit 15 -- I'm jumping ahead.

1 But Exhibit 15, the notes during -- at the bottom of the
2 exhibit, this is essentially what -- the examiner is
3 disputing that any improvements have been made. Now,
4 again, with respect to the improvements that the taxpayer
5 maintains, it's both to the -- it's a cosmetic
6 improvement. They painted. They put tile, and they've
7 got new bathrooms.

8 In addition, they've hired an adviser to do
9 advertising. And as the agent points out on Exhibit 15,
10 due to their lunch specials, maybe these differences are
11 occurring due to these lunch specials. So we know that
12 during their -- his observation, there were new things
13 occurring. And those new things that were occurring are
14 essentially enhancements to the business. They have lunch
15 specials. They now accept credit cards, and the place
16 looks clean and inviting.

17 Also, there was a shift. I believe in the work
18 papers you'll see where the -- excuse me -- the examiner's
19 work papers. The menu is also skewed a lot more towards
20 Indian food, and that has generated a lot more in sales.
21 So that's what we found so disingenuous that if sales are
22 going up as evidenced by the federal tax return, the agent
23 is maintaining that they are underreporting their
24 expenses. And because they're underreporting their
25 expenses, he can't -- he doesn't want to use his markup

1 analysis.

2 Again, as spoken earlier, the remedy for that is
3 contact the vendor. They will have a sales history to
4 these restaurants. This restaurant doesn't change its
5 food supplier. That's usually not good for a restaurant
6 when they do that. So with respect to deviation from the
7 Audit Manual, there's no justification. What should have
8 been done is probably to focus on the markup analysis. Or
9 earlier, when the auditor or the examining agent used --
10 expanded and used the two-week and then went to a
11 two-month. That came to a 24 percent error rate for which
12 we did dispute because of certain factors. But the error
13 rate that's being applied today is over 70 percent.

14 And when we look at the markup analysis, which is
15 determined to be within the CDTFA's guidelines, when we
16 look at the reconciliation of bank statements, the bank
17 deposit analysis, even the examining agent on his work
18 paper -- and that is Exhibit 13. Exhibit 13 is the
19 agent's bank deposit analysis, and we can see from his
20 analysis that the reported sales exceed the bank deposit.
21 Well, we know why. Some money has to be left inside the
22 locations. And they also keep petty cash for which the
23 agent confirmed that's reconciled monthly by Mohammed
24 Shahbaz.

25 So at the end of the day, we're unclear why this

1 bank deposit couldn't be used. We know that the sales are
2 exceeding what's being deposited. And so with respect to
3 reported sales, we can examine and confirm that using
4 alternative methods, foremost, the markup commutation.

5 In addition, the other test. So we have four
6 tests performed by the examining agent all within
7 generally a single digit error rate except for the
8 two-month observation, which is 24 percent. However, he
9 puts that aside and maintains, I'm going to go forward and
10 utilize the results from my one-day site observation.
11 That one-day site observation delivers a 70 percent error
12 rate. And so we sit back and say, how do you reconcile
13 four other tests generally all around 10 to 12 percent
14 averaging, and yours is 70 percent. We know that with
15 respect to the Audit Manual, you've got to demonstrate
16 that your conclusions are reasonable.

17 But in the face of all of your other work that's
18 been performed, there's no analysis determining that this
19 is reasonable. The only thing that he maintains is, I'm
20 using my one-day site observation, and these are the
21 statistics that it generates. So as I pointed out earlier
22 in Exhibit 8, even the Board at page 3, line 23 to 24,
23 they're citing the Audit Manual to say, I think you need
24 to go back and probably expand it.

25 Now, they do address the fact the petitioner was

1 opposed to expanding the observation test, but there's no
2 other discussion other than that. What taxpayer is going
3 to welcome is an increased test. What we maintain is the
4 taxpayer was not notified of any type of consequences.
5 Taxpayer should have been admonished that, look, it's in
6 your best interest to allow this to occur. Otherwise,
7 we're going to go back, maybe contact your vendors get
8 your supply history to see what you're paying and
9 determine whether or not your expenses are accurate. And
10 if they're not now, you know, we've got a lot more
11 information and maybe it's not a negligence penalty
12 anymore.

13 But none of that ever occurred, and we believe
14 consistent with the Audit Manual, taxpayer has the right
15 to be informed as to what's going to occur. Now, when the
16 taxpayer, according to this Exhibit 8, when a taxpayer
17 indicated, I don't want to have another inspection, the
18 taxpayer representative stepped up and provided additional
19 records. So with respect to the taxpayer, the taxpayer is
20 trying to demonstrate, look, is there anything else we can
21 do besides another site observation? Take another two
22 weeks of records. Take another two months of records. We
23 see that was performed. There was no summons. There was
24 no compelled disclosure. The taxpayer volunteered these
25 trying to demonstrate that your sample is not accurate.

1 So at the end of the day what we have here is,
2 again, the taxpayer has just basically been waiting for an
3 explanation. How do we deviate from the Audit Manual?
4 And equally important, how do you reconcile these
5 conclusions to be reasonable when, in fact, you performed
6 all these other tests that demonstrate your error rate
7 is -- is so skewed, it doesn't even come close to the
8 higher -- the highest error rate that you have computed
9 independently.

10 And so, again, what I'd like -- I don't want to
11 go into -- most of the schedules that I have attached as
12 exhibits are basically highlighting the fact that the
13 measure is predicated upon the one-day site observation.
14 They are projecting sales based upon those -- that day.
15 We know that the Manual says that can't be done. We can
16 use it to impeach, and he did use it to impeach. But
17 instead of doing an alternate course, what he says is, I'm
18 not going to rely on your records because I've impeached
19 those records, and now I'm using a device that I've used
20 to impeach your records to project the measure.

21 Well, we know that -- I apologize for not having
22 the cite memorized. I should. Within --

23 JUDGE STANLEY: Can you speak into the
24 microphone, Mr. Speiser?

25 MR. SPEISER: I apologize, Your Honor.

1 JUDGE STANLEY: Thank you.

2 MR. SPEISER: Consistent with the Audit Manual
3 0810.30, this test cannot be used to project sales without
4 expanding the period to a full three days.

5 Now, Your Honors, I'm reading a revised statute
6 dated January 2017. I understand that this audit involves
7 some periods before that. We did go and try to obtain an
8 earlier revised statute. We were not able to, but I'm
9 making a representation to the Court that based upon the
10 article that I did read, it's consistent that you cannot
11 use a one-day site observation to project sales. There
12 were some articles that they were discussing maybe two
13 days, but as of January 17th, it is clear the -- it's
14 mandated that it must be three days. Also, it's not
15 permissive language. It is mandatory language that a
16 one-day site test cannot be used to project sales.

17 And so with respect to our other exhibits, we're
18 bringing to Your Honors' attention that these other work
19 papers within the -- I mean, they are quite voluminous.
20 And so we just want to bring it to your attention that
21 these work papers are intertwined. The foundation for
22 these work papers is the one-day site test. They are
23 using the projected sales to determine the measure.

24 JUDGE STANLEY: Is that it that you have to say
25 for now?

1 MR. SPEISER: That's it. That's all I have for
2 now, yes.

3 JUDGE STANLEY: Okay.

4 Judge Cho, do you have any questions?

5 JUDGE CHO: Yeah. I wanted to ask a couple of
6 clarifying questions. So as I understand your argument,
7 you -- the taxpayer did not want to expand the one-day
8 observation test at some point during the audit; is that
9 correct?

10 MR. SPEISER: Yes, that would be correct. Well,
11 he wasn't inclined to. He was asked, and he said I don't
12 want to.

13 JUDGE CHO: Okay. So -- and in response he
14 requested to provide additional documentation of a
15 different kind, such as, you said a two-week period and
16 then a two-month period of records; is that correct?

17 MR. SPEISER: Yes. For additional clarification
18 the taxpayer was not using any type of automated software.
19 During the end of this period, they did install, in
20 connection with improvements to their location, they got a
21 system, Z-tapes. And that's why they said, look, we got
22 this system in place. How about we give you two weeks'
23 worth of or two months' worth of records? And so the
24 agent first said I want the two weeks. He looked at the
25 two weeks. There were issues.

1 And then the taxpayer said can we expand that?
2 I'll give you more records. I think your two weeks needs
3 to be expanded based on what they were discussing. They
4 volunteered this. They -- it's -- it's -- and then they
5 give them the two months, and based upon those findings,
6 the agent determined there's a 24 percent error rate. But
7 then he maintains, you know what, I can't rely upon these
8 records. So I'm not going to rely upon these records.

9 JUDGE CHO: Okay. And at some point in time,
10 during the audit, the taxpayer was aware the Department
11 was going to use the one-day observation test to project.
12 I'm sure they received the audit working papers at one
13 time. When they were aware, why didn't the taxpayer allow
14 the expansion of the observation test in that point in
15 time.

16 MR. SPEISER: What's interesting and I believe
17 what should have been done is basically go back and advise
18 the taxpayer of what these determinations are looking
19 like. Taxpayer was never given the opportunity to say,
20 based upon this, are you going to allow us to come back?
21 Because the way that this -- the write-up occurs and based
22 on my communications with the client, essentially, what
23 had happened was they -- the site observation was
24 conducted, and then there were issues, and they said we'd
25 like to go back. He says I really don't want to. Can you

1 just have more records, so the agent took more records.

2 At no point in time was there ever a discussion
3 that we're going to use a one-day site observation. At no
4 point was this ever represented to the taxpayer or the
5 taxpayer's representatives. I believe, if in fact that
6 was, because I believe the taxpayer's representatives were
7 competent. They would --

8 JUDGE CHO: I'm going to stop you right now just
9 to kind of speed this up a little bit.

10 MR. SPEISER: Sure.

11 JUDGE CHO: If you look at the 414-Z, which is on
12 page 92 of the Department's exhibits, it's Exhibit F.
13 It's the audit working papers. It looks like the audit
14 was sent to the taxpayer's representative Mr. Dryer by
15 email on June 13th, 2012. And at that point, once you
16 receive the audit working papers, you're pretty much aware
17 of how the Department is coming out to their
18 determination. My question then is why wasn't the
19 observation test expanded at that point in time?

20 MR. SPEISER: If you look at Mr. Dryer's
21 response, Mr. Dryer's response is, essentially, your
22 sample is not accurate. That's what Mr. Dryer's response
23 is. Mr. Dryer is requesting --

24 JUDGE CHO: Just a reminder to please speak into
25 the microphone.

1 MR. SPEISER: I apologize. Sorry, Your Honor.

2 Mr. Dryer's response is your sample is not
3 reliable. Let's increase it. That has always been the
4 taxpayer's contention because they don't have a reliable
5 sample. I mean, based upon statistics, you've got to have
6 a solid foundation. Otherwise, you start having these
7 outliers and different issues. At no point in time -- and
8 when you read the write-up, I don't think a layman will
9 understand how this is being determined. What they're
10 looking at is, what is the amount that is, you know, they
11 say I owe.

12 And so when you go through this, I'm not saying
13 that it's artful writing, but it is very persuasive. You
14 forget the fact that this is predicated on a one-day site
15 observation. They start intertwining all these other test
16 results and you lose focus that -- these are all red
17 herrings. It has nothing to do with your markup analysis.
18 It has nothing to do with your bank deposits. It has
19 nothing to do with your cash sales. The examining agent
20 at least verified that was reconciled at the end of every
21 business day, because they're a cash business early on in
22 the period.

23 So with all due respect, I don't believe the
24 taxpayer is ever on notice or put on notice that, hey,
25 this is predicated on a one-day site observation. From

1 reading the report, basically, it gets buried in all types
2 of other references. You know, they're talking about
3 supplies not being accurately stated. He talks about his
4 bank deposit analysis. He talks about the average sales.
5 Well, the average sales come from his site observation.

6 So all of this is tainted, and I don't believe
7 that the burden should be upon the taxpayer, rather every
8 individual has a duty to at least follow the requirements,
9 their code. They're given a rule book, and we should all
10 follow the rules. If you don't follow the rules, then
11 there's consequences. We don't have any type of order if,
12 in fact, we're not going to adhere to the rule book.

13 JUDGE CHO: All right. Thank you very much.
14 Those are the only questions that I have.

15 JUDGE STANLEY: Judge Brown, do you have any
16 questions?

17 JUDGE BROWN: I may have one or two questions.
18 Mr. Speiser, you referred to the renovations to the
19 restaurant.

20 MR. SPEISER: They're not renovations, they are
21 more improvements.

22 JUDGE BROWN: And were those improvements made to
23 all four locations or --

24 MR. SPEISER: Most -- I believe so. I believe
25 that they spent approximately \$100,000, and it was just

1 basic tile paint and bathrooms. And then they put in the
2 credit card system and their marketing. But they're not
3 enlarging the space. There's no structural improvements.

4 JUDGE BROWN: So it's not changing the seating?

5 MR. SPEISER: It's -- yeah.

6 JUDGE STANLEY: And I guess my question is when
7 you were referring to the --

8 MR. SPEISER: I don't even know if they were
9 changing the seating. I think it was just paint and tile.

10 JUDGE BROWN: Okay. And are there any pages in
11 the exhibits that you want to point me to that are
12 evidence of --

13 MR. SPEISER: The federal tax returns. The
14 federal tax returns were referenced in the write-up. They
15 were given to the state. And so if they're not in -- I
16 thought they were in the State's work papers because they
17 were provided. But that was the part where we said, look
18 at -- if you look at the depreciation schedules, you could
19 see that money is being spent. But the agent wrote up, I
20 don't see any substantiation.

21 JUDGE BROWN: And then you -- during the
22 presentation and then your briefing, you referred to the
23 Board hearing, which seems like you're referring to the
24 actual Board members, but I don't see that in the
25 evidence. I see that there's a Board hearing summary, but

1 what I --

2 MR. SPEISER: It would be the Board hearing
3 summary. That's all we received from the Board hearing.
4 I don't believe we received anything else, other than
5 their summary, which is their ruling.

6 JUDGE BROWN: Well, the Board hearing summary --

7 MR. SPEISER: Is different from a ruling. When I
8 said that, I'm going -- so what I have here, again,
9 because this goes back. It would just be the summaries.

10 JUDGE BROWN: And so there's no indication that
11 the Board members actually met and discussed this case
12 during the Board hearing; correct?

13 MR. SPEISER: Well, these summaries are prepared
14 by the Board; correct? It's not prepared by -- I mean,
15 this is after our hearing, this is what gets circulated,
16 no?

17 JUDGE BROWN: No.

18 MR. SPEISER: Then who prepares them?

19 JUDGE STANLEY: But I just wanted to clarify your
20 argument. I didn't --

21 MR. SPEISER: Okay. Because, again, what we're
22 relying on -- what we're trying to communicate today is we
23 had gone forward to the BOE and had an oral hearing
24 pre-CDTFA. At that hearing, the -- one of the elected
25 members pointed out the fact -- and this is why we believe

1 it was taken off calendar later, because we contacted
2 their office. They called us back before the supplemental
3 D&R was issued, and said, look, have you gotten anything
4 yet? We said no.

5 They said we don't believe that they're going to
6 address the reasonableness of their conclusions. So when
7 you go back to your next hearing, you need to emphasize
8 that. That hearing then was taken off calendar that week.
9 We waited over four-and-a-half years for that supplemental
10 D&R. Then it's finally issued, and it's nonresponsive.
11 It's basically just no change is made to it at all.

12 And that's what we're utilizing these for.
13 Again, it's our understanding that it was prepared by, you
14 know, whoever is the administration with the Board hearing
15 because the Board points out on page 3, they expected
16 consistent with the Manual that this -- excuse me -- that
17 your observation be larger if you're going to be
18 projecting sales. So they sent it back and told them to
19 fix it. And to this day, it has not been fixed. They are
20 still using the one-day site observation as predicate for
21 their projected measure.

22 JUDGE BROWN: I don't have anything further right
23 now. Thank you.

24 MR. SPEISER: You're welcome.

25 JUDGE STANLEY: Okay. And I don't have any

1 questions, but I do have a few clarifications before we
2 move to CDTFA's presentation. I know, Mr. Speiser, that
3 you're an attorney so you're probably used to being in
4 court, but we -- I have to clarify for the public that we
5 are not a court. We're an administrative hearing body.
6 So just to make that clear. And you don't have to call us
7 Your Honor, either. You can call us Judge Stanley, Brown,
8 and Cho.

9 And then with respect to a couple of other
10 questions that just came up. Judge Brown, you can look on
11 page 80 of CDTFA's exhibits for Schedule 12-B that lays
12 out the federal income tax returns.

13 And I'm going to ask Mr. Suazo as part of his
14 presentation if he can just answer the question that was
15 raised about what a Board hearing summary is and who
16 prepares it, whether it's prepared before or after a Board
17 hearing. Okay.

18 So, Mr. Suazo, you can proceed when ready.

19

20 PRESENTATION

21 MR. SUAZO: The Appellant operates four
22 restaurants in the Bay Area, one in Hayward, one in
23 Fremont, and two in San Francisco. Only two locations
24 accepted credit cards. All restaurants specialized in
25 Pakistani and Indian-style food. The seller's permit was

1 closed out effective March 31st, 2012, due to a
2 reorganization.

3 The audit period covers from October 1st, 2008,
4 through the close-out period of March 31st, 2012. Records
5 reviewed included federal income tax returns for 2008,
6 2009, and 2010, bank statements, daily summary reports,
7 point of sale system data for the period from February
8 1st, 2012, through March 21st, 2012. Comparison of
9 federal income tax returns to sales and use tax reported
10 sales disclosed minimal difference; Exhibit F, page 80.
11 Comparison of sales to cost of goods sold for federal
12 income tax returns disclose an overall markup of 388
13 percent; Exhibit F, page 79.

14 Markups for 2008 was over 500 percent. The
15 markup appears high in comparison in industry averages for
16 this type of business. The cost of goods sold appears to
17 be understated. The purchase invoices were not provided;
18 Exhibit F, page 49. So no verification could be conducted
19 to validate recorded cost of goods sold. Bank deposits
20 for each location were scheduled and quarterly summaries
21 were compared to reported sales for the period from
22 October 1st, 2008 through September 30th, 2011. No major
23 differences were noted; Exhibit F, page 81.

24 Reconciliation of recorded sales amounts to
25 reported sales revealed minimal differences; Exhibit F,

1 page 77. Recorded February and March sales for 2009,
2 2010, and 2011 were compared to February and March sales
3 of 2012. Results showed minimal differences; Exhibit F,
4 pages 61 to 66. Observation tests were undertaken to
5 verify the validity of the recorded sales amounts.

6 Observation tests were conducted on all four
7 locations for Wednesday, May 30th, 2012. The observation
8 test revealed ex tax sales for all locations amounted to
9 just over \$6,100. Average recorded Wednesday sales for
10 all four locations for the period from January 1st, 2011,
11 through September 30th, 2011, that amounted to just an
12 average of \$3,487; Exhibit F, page 56.

13 The observation test also disclosed that for two
14 restaurants that did accept credit cards for payment had a
15 40 percent credit card to cash ratio for the O'Farrell
16 location in San Francisco, and 36 percent credit card to
17 cash ratio for the Hayward location. A percentage of
18 error was computed using the time frame closest to the
19 part of the year that the observation tests were
20 conducted, Wednesday, May 25, 2011, and Wednesday,
21 June 1st, 2011. The sales were totaled and averaged and
22 compared to the observation results to compute a 70
23 percent percentage of error; Exhibit F, page 55.

24 The percentage of error was applied to reported
25 sales and total audited sales for almost \$7 million. When

1 compared to the reported sales of \$4.1 million, a
2 difference of unreported taxable sales of \$2.9 million;
3 Exhibit F, page 54. The Appellant states that a one-day
4 observation test is not representative. However, the
5 Appellant did not allow for the audit team to conduct more
6 observation tests, which is on Exhibit A, page 21.

7 In preparation for this hearing, the Department
8 was able to obtain 1099 credit card information for 2011
9 for the Hayward and O'Farrell San Francisco location.
10 1099-K data was also obtained for 2012 but only for the
11 Hayward location. Now, if you can indulge me, please go
12 to Exhibit G. On Exhibit G there's analysis of a 1099-K
13 data.

14 Exhibits G, pages 113 to 117 discloses the
15 following: Credit card ratios from the observation test
16 showed the Hayward location had a 36 percent -- the
17 Hayward location had 36 percent of sales paid for with
18 card, and O'Farrell-San Francisco location had a
19 40 percent of sales paid for with credit cards. That's on
20 Exhibit G, page 114. The credit card ratio for each
21 location was applied to the respective 1099-K credit card
22 sales reports.

23 After adjustments were made for tips and sales
24 tax included, the computed combined sales for both of
25 these locations was \$94,000. And that is on Exhibit G,

1 page 113. Recorded sales, which are on Exhibit G,
2 page 115, obtained from the Appellant's financial
3 statements for the same two locations combined for a total
4 of \$449,000. Again, that's on Exhibit G, page 115. So
5 that's what he recorded. So when you look on page 113,
6 what you're going to see is that the disclosed difference
7 of \$544,000 in sales is more than double what is recorded
8 for the two combined locations. Again, that's on
9 Exhibit G, page 113.

10 The combined percentage of error for this
11 nine-month period is over 120 percent. I'm going to
12 Exhibit G, page 115 --or page 117. Excuse me. Comparison
13 of 1099 credit card information for the same nine-month
14 period disclosed that credit cards made up almost 90
15 percent of the bank deposits. Again, the credit card
16 ratio of sales observed in the observation tests showed
17 credit card payments accounted for 36 percent of the
18 Hayward's location sales and 40 percent of the
19 O'Farrell-San Francisco location sales. Based on these
20 ratios, a vast majority of the cash sales are not being
21 deposited into the bank accounts, and are not being
22 recorded into the Appellant's financial statements.

23 Also on page 116, comparison of the credit card
24 sales for the Hayward location for the fourth quarter of
25 2011 were over \$130,000. Yet, reported sales using the

1 local sales tax amounts were only \$104,000 for the first
2 quarter for 2012. The 1099-K shows \$160,000 worth of
3 sales using the credit card deposits. However, there was
4 only \$98,000 reported for the Hayward location, so again,
5 we have a vast difference.

6 Because credit card sales are far greater than
7 the reported sales for the Hayward location, it stands to
8 reason that not all sales from the restaurant are being
9 properly reported -- properly recorded in the Appellant's
10 financial statements and reported on the Appellant's sale
11 and use tax returns. In summary, the 1099-K analysis
12 shows Appellant vastly underreported the sales in both the
13 reported and recorded sales. The analysis also validates
14 that the observation tests were representative, and the
15 70 percent percentage of error is conservative.

16 Revenue & Taxation Code 7054 authorizes the
17 Department to examine the books, papers, records, and
18 equipment of any person selling personal property, and the
19 Department may investigate the character of the business
20 to verify the accuracy of any return made. Moreover,
21 Revenue & Taxation Code 6481 states that if the Department
22 is not satisfied with the return or returns of amount of
23 tax or other amount required to be paid to the State by
24 any person, it may compute and determine the amount
25 required to be paid upon the basis of the facts contained.

1 In the return or returns or upon the basis of any
2 information within its possession or that it may come --
3 or that may come into its possession. Sorry. Here the
4 Department examined Appellant's books and records. And
5 even though it found them to be complete and in
6 agreement, the Department was within its rights under
7 Sections 7054 and 6481 to examine behind the books.

8 Accordingly, the Department's use of alternative
9 method to compute and determine taxable sales in the
10 applicable sales tax that should have been reported for
11 the audit period was reasonable. Also, if you happen to
12 look at the federal income tax returns, on the federal
13 income tax returns, normally, what we find is that rent is
14 around ten percent of what sales should be. If you look
15 at what the amount of total sales that was computed by the
16 Department and you compare it to the rent, it is within
17 around the ten percent. Maybe a little bit higher, but
18 it's going to be in there.

19 The taxpayer's federal income tax returns shows
20 over 20 percent of rent as part of sales. So it's way
21 higher than what historically it should be. Again, this
22 points to the reasonableness of the Department's findings.
23 So, again, the Department has shown that its determination
24 was reasonable and the Appellant has not provided
25 sufficient evidence or other documentation to prove

1 otherwise.

2 This concludes my presentation. I'm available to
3 answer any questions you may have.

4 MR. PARKER: Judge Stanley, I just wanted to add
5 you asked us to address the Exhibit 8, the Board hearing
6 summary. The Board hearing summary is a document prepared
7 in preparation for an upcoming Board hearing. It was
8 developed by our Appeals Division to give a summary of the
9 audit in the case and the issues that are currently under
10 issue for the Board and the Board members and their staff
11 in preparation for the hearing before the Board. So it's
12 a document prepared in advance of the hearing, and it's
13 not a summary of the actual hearing that took place.

14 JUDGE STANLEY: And does the Department know
15 whether a hearing actually ever occurred in this matter?

16 MR. SUAZO: I did not see a hearing actually
17 occurring. I can go back and check again.

18 JUDGE STANLEY: Just to clarify, I did ask for
19 copies of the agenda or minutes from that meeting, if it
20 occurred, and we didn't receive anything. So I'm assuming
21 it may not have occurred.

22 Judge Cho, do you have any questions?

23 JUDGE CHO: Yes, just one clarifying question, I
24 hope. So based on Exhibit G, the credit card sales
25 information analysis, it's the Department's position

1 that -- at least with respect to those two stores that did
2 accept credit cards -- if they were to do kind of a more
3 in-depth analysis, the error rate that would have been --

4 MR. SUAZO: It would have gone up.

5 JUDGE STANLEY: Would have gone up to about
6 121 percent; is that correct?

7 MR. SUAZO: Yes. And that's over a nine-month
8 period, not a one-day period.

9 JUDGE CHO: And then if you had projected that
10 error rate to the entire audit, this would have been a
11 much larger audit; is this --

12 MR. SUAZO: Yes. Also, if you look on Exhibit G,
13 for those two Hayward locations in the fourth quarter 2011
14 and first quarter 2012, I believe, the sales are higher
15 than what was reported to us for the Hayward location
16 based on the local tax that was deferred to that area.

17 JUDGE CHO: Okay. Thank you. That's the only
18 question I have. Thank you.

19 JUDGE STANLEY: Judge Brown, do you have any
20 questions?

21 JUDGE BROWN: I think I may just have one or two.
22 Does CDTFA want to make any argument about application of
23 the negligence penalty, considering that this was a
24 first-time audit.

25 MR. SUAZO: The amount is very material.

1 Basically, running the locations on their own, the person
2 would have known that it was being well underreported. So
3 because of the significance and the materiality, the fact
4 that they would have known, the fact that if you look at
5 the bank deposits by themselves for those two locations,
6 it makes up 90 percent. And if you see, based on the
7 information that was provided to us on that site test, it
8 should have been 36 percent for the Hayward location and
9 40 percent for the San Francisco-O'Farrell location.

10 There's no -- they would have known that it was
11 being not reported properly. As a matter of fact, it
12 looks like the only -- I mean, in a way it sort of looks
13 like just one shift is being reported. If they had two
14 shifts, a lunch shift and dinner shift, it looks like only
15 one shift is being reported.

16 JUDGE BROWN: Thank you. I have no further
17 questions right now.

18 JUDGE STANLEY: Okay. And I don't have any
19 questions. So I'm going to give Mr. Speiser ten minutes
20 to respond to what has been said and to conclude.

21 MR. SPEISER: Thank you.

22

23 CLOSING STATEMENT

24 MR. SPEISER: I do take issue with the
25 conclusions that are being advanced here. Again, we are

1 dealing with a one-day site observation. The State
2 maintains that due to difficulties in getting
3 information -- which we do not see anywhere being
4 addressed -- that they are unable to get records in
5 connection with their expenses, cost of goods sold.
6 Again, if a taxpayer is not going to comply with a
7 voluntary request, the State has alternative means of
8 obtaining that information.

9 Today we're talking about the fact that the state
10 maintains that their rent is questionable. It should be a
11 lower percentage. It's too high. That's simple to
12 verify. If, in fact, the State has concerns, why don't we
13 just request the lease or lease payments. With respect to
14 the expenses that the State says the taxpayer alleges is
15 not providing, notwithstanding the fact that the taxpayer
16 is providing an additional two months' worth of records to
17 try and demonstrate that the sample needs to be enlarged,
18 why doesn't the State just say, if you're not going to
19 give us the identity of your suppliers, then we'll summons
20 it. We'll obtain it on our own.

21 I don't know. I forgot my colleague's term was
22 we're going to go behind the numbers. Well, why don't we
23 do that all the way around. Again, we maintain that no
24 point in time was the taxpayer ever advised that a one-day
25 site observation is all he's entitled to. There were four

1 other tests that were performed. None of those results
2 can even be reconciled to determine that the 70 percent is
3 reasonable.

4 Now, we're talking about error rates over
5 100 percent. Again, the taxpayer maintains no
6 consideration has been given to year-over-year growth. No
7 consideration has been given that a new system has been
8 inputted into these locations now so they can all accept
9 credit cards. We live in a digital society today. No
10 consideration is being given to any improvements alleged
11 to have been made and substantiated by the federal income
12 tax returns.

13 And no consideration is given to the fact that an
14 advertising program has been put in place advertising
15 lunch and dinner specials for which when the agent comes
16 across a -- an error rate that is not suitable for him, he
17 writes it off as, well, just must be in connection with
18 their new programs. Well, that's contradicting themselves
19 because he's saying I don't see any evidence of new
20 programs. So, again, at the end of the day, the entire
21 measure here is predicated upon a site observation that is
22 in violation of the Audit Manual.

23 If, in fact, the agent had issues that they are
24 alleging today that he couldn't get the records, there are
25 plenty of devices in the Audit Manual afforded to an agent

1 when you have uncooperative taxpayers. However, the
2 record here demonstrates that you don't have an
3 uncooperative. So I don't believe at any point in time
4 the taxpayer refused to give any information surrounding
5 their accounting records.

6 And with respect to their request for an
7 additional site observation, that's a bit nefarious.
8 Because, again, they're asking. He's saying no, and then
9 they're going to discuss these other issues. At no point
10 in time did they ever come back and say, do you want to
11 reconsider? And we believe that is predicated on notions
12 of fairness and due process.

13 And, again, that's essentially what the taxpayer
14 maintains that they have not been deprived, but the State
15 is now attempting to manipulate their conclusions to fit
16 into their argument when, in fact, there are plenty of
17 other alternatives. And we know the amount of time that
18 was spent on this case by the agents. They certainly had
19 the opportunity to either compel a disclosure, or use an
20 alternative test that produces reliable conclusions like
21 the markup.

22 Thank you.

23 JUDGE STANLEY: Thank you, Mr. Speiser.

24 Judge Cho, do you have any follow-up questions?

25 JUDGE CHO: Yes. I just wanted to clarify

1 something.

2 So, Mr. Speiser, you're saying that credit cards
3 were accepted at all the locations or was it just two of
4 the locations as the Department is saying?

5 MR. SPEISER: Well, again, so they -- in the
6 beginning they were cash. They did not accept credit
7 cards. During the course of the audit and when the site
8 observation occurred, at that point in time, they had a
9 POS system put into place. It was towards the end of the
10 examination period. And I believe that's why the agent
11 said, I'll tell you what. Give me the last two weeks of
12 your Z-tapes. Okay. Give me the last two weeks of
13 Z-tapes, and then I'll examine those.

14 When that came back, that two-week analysis
15 produced an error rate of less than 15 percent. But the
16 taxpayer maintained, hey look, you've got issues. And if
17 I can bring your attention to Exhibit 10 --

18 JUDGE CHO: I'm sorry, Mr. Speiser, the question
19 was just is --

20 MR. SPEISER: Well, because it relates to --

21 JUDGE CHO: -- were there credit cards at two
22 locations or four locations?

23 MR. SPEISER: At the end they were all accepting
24 them now.

25 JUDGE CHO: Okay. Then just one second. Thank

1 you.

2 Mr. Suazo, the Department said that it was only
3 two locations.

4 MR. SUAZO: If you go to page -- if you go to
5 page 96 -- let me know when you're there.

6 JUDGE CHO: All right. I'm there.

7 MR. SUAZO: Okay. So you see on the Z out cash
8 Number 186, \$2,137.71, there's no room for credit cards.
9 It's all cash. That's the 16th Street location in San
10 Francisco. And then if you go down a few pages, if you go
11 to the Fremont one, that's on page 99, you see cash
12 Number 59, \$849.19. Again, cash only. No credit cards.

13 JUDGE CHO: Okay. Thank you, Mr. Suazo.

14 MR. SUAZO: Okay. Another thing I would like to
15 bring up is that when she asked me about the negligence
16 penalty, the records weren't maintained in a prudent
17 manner as we couldn't get the purchases to verify for the
18 cost of goods sold. I forgot to tell you that earlier.

19 JUDGE CHO: Okay. Thank you. That's the only
20 question that I had. Thank you.

21 JUDGE STANLEY: Judge Brown, do you have any
22 follow-up questions.

23 JUDGE BROWN: I do not have any follow-up
24 questions. Thank you.

25 JUDGE STANLEY: Okay.

1 And, Mr. Speiser, I just had one that you may not
2 be able to answer since you weren't representing the
3 Appellant during the audit. But do you know of any reason
4 why during the audit process or shortly after the first
5 audit you wouldn't -- Appellant wouldn't have offered to
6 provide vendor records so that they could do a markup
7 analysis?

8 MR. SPEISER: My communications with the taxpayer
9 indicate that they gave their records to their reps, their
10 accounting records. It's my understanding that the
11 examining agent had access to all of their accounting
12 records. So with respect to depriving the identity of the
13 charge, that to me makes no sense at all. I do not
14 understand what he was referring to. Because, again, at
15 the end of the day if, in fact, in a case like this it's
16 warranted that that examining agent has access to that.

17 And Mr. Dryer, from my understanding, is a very
18 competent rep. There's no reason why he would not give
19 that. But based upon the write-up it appears that his
20 request was not compiled with. So why doesn't the agent
21 just go ahead and say, if you're not going to give it to
22 me, I'll get it. Because he wants to perform a markup
23 analysis.

24 JUDGE STANLEY: Okay. I understand your position
25 on that.

1 I don't have any further questions. I do have a
2 matter of the interest -- potential interest abatement.
3 And we do not have it in our file that Appellant has ever
4 filed the required written statement under penalty of
5 perjury claiming interest abatement for certain time
6 periods. Is your client willing to provide that?

7 MR. SPEISER: Sure. Essentially, my client's
8 argument is just due to administrative delay. It took
9 over four-and-a-half years for a supplemental D&R to be
10 issued with no change to that D&R. We're not alleging due
11 to Covid. We understand that's out of everyone's control.

12 JUDGE STANLEY: So if I give you some time to get
13 that statement under penalty of perjury, you can feel free
14 to use -- I think it's CDTFA Form 735 or just write your
15 own statement, if you choose. But they need -- I'm going
16 to give them time respond to that, and CDTFA at this point
17 doesn't know which time periods you're addressing and how
18 to respond to it.

19 So that statement helps them to know whether they
20 believe the delays were reasonable under the circumstances
21 and not Appellant's fault or caused by Appellant in any
22 way. So how long do you think you need to get that
23 statement?

24 MR. SPEISER: Two weeks only because I'll be
25 traveling. If I could get it done sooner, I'll get it out

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sooner.

JUDGE STANLEY: Okay. Two weeks is reasonable.
I don't want this case to languish anymore than it has to.

MR. SPEISER: I agree. I agree.

JUDGE STANLEY: And, Mr. Suazo, how long does the
Department wish to have to respond to whatever is provided
by Appellant?

MR. SUAZO: 30 days.

JUDGE STANLEY: 30 days.

MR. PARKER: Judge Stanley?

JUDGE STANLEY: Yes.

MR. PARKER: Can I just ask that the Appellant be
specific about the periods that they are requesting the
interest relief from so that we can focus our
investigation on those periods.

MR. SPEISER: That's reasonable.

JUDGE STANLEY: As I said, they don't know what
they're responding to at this point. So if you put in
your statement the specifics, it'll be really helpful.

MR. SPEISER: Okay.

JUDGE STANLEY: Okay.

So I'm going to hold the record open for
additional briefing for the two weeks plus the 30 days,
and once we -- once that process is complete, we'll close
the record, and then we'll issue a decision within

1 100 days, not 20. I'm fast but not that fast. And that
2 is all we have for today. No more cases are scheduled.
3 So we're going to adjourn for today.

4 MR. SPEISER: I know it's unorthodox, but before
5 we adjourn, I just wanted to comment on two of my
6 exhibits. Would that be possible? Just real briefly,
7 based upon Counsel's recent statements. I think it's
8 relevant with respect to --

9 JUDGE STANLEY: Is it something you have to
10 respond to that they just said?

11 MR. SPEISER: No. It -- possibly, but
12 essentially in connection with the observation. My
13 colleague was talking about the O'Farrell location and the
14 credit card and sales. Again, we want to emphasize we're
15 looking -- the observation occurs outside of the audit
16 period, and we're relating back sales to a period when
17 credit cards were nonexistent. But with respect to the
18 O'Farrell location, if you look at my Exhibit 10, at the
19 O'Farrell Street location on the subsequent Sundays --
20 that would be February 5th and February 12th -- the gross
21 receipts are \$1,082 and \$540. You can see those in
22 Column 1 on Exhibit 10.

23 For each day of the week for the month of
24 February 2012, four to five days of gross receipts were
25 analyzed, and only one day, Monday, to the observed sales

1 for any given day during February 2012 exceed the average
2 sales for said day of the week during 2009 to 2011.
3 That's -- and if you go to Exhibit 11, that also
4 demonstrates that only one day did observed sales exceed
5 the average.

6 For Mondays the maximum sale exceeded the minimal
7 sale by 50 percent. Such a small population and minimal
8 data can easily be skewed, and that's what we maintain is
9 occurring here. And that's why the taxpayer basically
10 requested to increase the scope, giving more records. So
11 by eliminating these outliers in 10 and 11 from the
12 projected sales, you eliminate those outliers, and your
13 error rate is less than 15 percent.

14 And, again, Exhibits 10 and 11 are basically from
15 the examination -- the auditor's worksheets. When you use
16 a small population, numbers can -- numbers get skewed.
17 You can make statistics talk, and we believe that's what
18 happened here based upon our analysis. None of these
19 sales -- only one day did the observed sales exceed the
20 average sales. There's no discussion about that.

21 JUDGE STANLEY: Okay. Thank you for clarifying.

22 So we'll go back now. And thank you all for
23 participating, and we'll adjourn the hearing and wish you
24 all a happy remainder of your afternoon.

25 (Proceedings adjourned at 4:22 P.M.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 3rd day of October, 2022.

ERNALYN M. ALONZO
HEARING REPORTER